TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 98-31

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether, under the facts presented, a 2nd tier subsidiary of a regulated financial corporation is a financial institution for Tennessee franchise, excise tax purposes and whether such a subsidiary should be included in the combined Tennessee franchise, excise tax return filed by the regulated financial corporation's holding company.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

(A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
(B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
(C) The applicable law must not have been changed or amended;
(D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[BANK HOLDING COMPANY] is the parent corporation for [BANK]. For Tennessee franchise, excise tax purposes, the Bank Holding Company is a holding company as defined in T.C.A. § 67-4-804(a)(8) and the Bank is a regulated financial corporation as defined in T.C.A. §§ 67-4-804(a)(11). The Bank Holding Company currently files a combined Tennessee franchise, excise tax return that includes only those members of its affiliated group that are unitary under T.C.A. § 67-4-804(a)(16) and that are "financial institutions" as that term is defined in T.C.A. §§ 67-4-804(a)(7).

Thus, not all of the entities that make up the Bank Holding Company's consolidated group for federal tax purposes are included in the Bank Holding Company's unitary group for purposes of Tennessee's combined financial institution franchise, excise tax return. The Bank Holding Company's unitary group, for example, does not include those entities that are not direct 1st tier subsidiaries of either the Bank Holding Company, the Bank or a regulated financial corporation within the unitary group and that are not conducting the business of a financial institution pursuant to T.C.A. §§ 67-4-804(a)(2(A). The Bank Holding Company states that such entities are not engaged in a unitary business with the Bank under T.C.A. § 67-4-804(a)(16).

The Bank proposes to restructure its business operations through a series of transactions. Pursuant to this proposal, the Bank will create a newly formed 100% owned entity, Corporation Y. Corporation Y will subsequently form Corporation Z in which it will own in excess of 80% of the stock. Corporation Y's only business activity will be the holding of its interest in Corporation Z.

Both Corporation Y and Corporation Z will be incorporated and domiciled in a state other than Tennessee and neither will have employees or property in Tennessee. Substantially more than 50% of Corporation Z's business assets will consist of securities and substantially more than 50% of its gross income will be derived from such securities. However, Corporation Z may also hold loans secured by real property.

QUESTIONS PRESENTED

1. Will Corporation Y and Corporation Z be considered financial institutions for Tennessee corporate franchise, excise tax purposes?

2. Will Corporation Y and Corporation Z be included in the Bank Holding Company's combined Tennessee franchise, excise tax return?

RULINGS

1. Under Tennessee law, Corporation Y is a financial institution. Corporation Z is not a financial institution under Tennessee law.

2. As a financial institution, Corporation Y will be included in the Bank Holding Company's combined Tennessee franchise, excise tax return. Since Corporation Z is not a financial institution under Tennessee law, it will not be included in the Bank Holding Company's combined Tennessee franchise, excise tax return.

ANALYSIS

1. CORPORATION Y IS A FINANCAL INSTITUTION
CORPORATION Z IS NOT A FINANCIAL INSTITUTION

For purposes of the Tennessee corporate franchise, excise tax, T.C.A. §67-4-804(a)(7) defines a financial institution as follows:

> "Financial Institution" means a holding company, any regulated financial corporation, a subsidiary of a holding company or regulated financial corporation, or any other corporation organized under the laws of the United States or any other taxing jurisdiction that is carrying on the business of a financial institution. However, "financial institution" does not include insurance companies subject to tax under §§56-4-201 - 56-4-214.

T.C.A. § 67-4-804(a)(2)(A) and (B) define the "business of a financial institution" as follows:

> (2) (A) "Business of a financial institution" means:
> (i) The business that a regulated financial corporation may be authorized to do under state or federal law or the business that its subsidiary is authorized to do by the proper regulatory authorities;
> (ii) The business that any corporation organized under the authority of the United States or organized under the laws of any other taxing jurisdiction or country does or has authority to do which is substantially similar to the business which a corporation may be created to do under title 45, or any business which a corporation or its subsidiary is authorized to do by title 45;
> (iii) Otherwise making, acquiring, selling or servicing loans or extensions of credit including, but not limited to, the following:
> (a) Secured or unsecured consumer loans;
> (b) Installment loans;
> (c) Mortgage or deeds of trust or other secured loans on real or tangible personal property;
> (d) Credit card loans;
> (e) Secured or unsecured commercial loans of any type;
> (f) Letters of credit and acceptance of drafts;
> (g) Loans arising in factoring; and
> (h) Any other transactions of a comparable economic effect;

(iv) Leasing or acting as an agent, broker or adviser in connection with leasing real and personal property that is the economic equivalent of an extension of credit; or

(v) Operating a credit card business.

(B) Notwithstanding the provisions of this subdivision (a)(2), if the business of a financial institution generates less than fifty percent (50%) of a corporation's gross income, the corporation shall not be considered to be a financial institution under subdivision (7). For purposes of this subdivision (a)(2)(B), the computation of gross income of a corporation does not include income from nonrecurring, extraordinary transactions;

For Tennessee franchise, excise tax purposes, T.C.A. § 67-4-804(a)(7) treats a corporation as a financial institution if it is not an insurance company subject to tax under T.C.A. §§ 56-4-201 - 56-4-214 and meets any one of the following criteria:

(a). It is a holding company as defined by T.C.A. § 67-4- 804(a)(8).

(b). It is a regulated financial corporation as defined by T.C.A. § 67-4-804(a)(11).

(c). It is a subsidiary of a holding company defined by T.C.A. § 67-4-804(a)(8).

(d). It is a subsidiary of a regulated financial corporation as defined by T.C.A. § 67-4-804(a)(11).

(e). It is carrying on the business of a financial institution as defined by T.C.A. § 67-4-804(a)(2).

When the above criteria are applied to the facts presented, the following conclusions are axiomatic for purposes of Tennessee franchise, excise taxes:

(1). Neither Corporation Y nor Corporation Z are insurance companies and neither fall within the scope of (a), (b) or (c) above.

(2). The Bank Holding Company is a holding company under criterion (a) above.

(3). The Bank is a regulated financial corporation and, under criterion (d) above, Corporation Y is a financial institution because it is a direct 1st tier subsidiary of the Bank.

(4). Corporation Z is not a subsidiary of a holding company under criterion (a) nor is it a regulated financial corporation under criterion (d) above[1].

Corporation Y qualifies as a financial institution under criterion (d) above because it is a direct 1st tier subsidiary of the Bank, a regulated financial corporation. Corporation Z is a direct first tier subsidiary of Corporation Y but Corporation Y is not a holding company as defined by T.C.A. § 67-4-804(a)(8) nor is Corporation Y a regulated financial corporation as defined by 67-4-804(a)(11). Therefore, Corporation Z will not qualify as a financial institution under (a), (b), (c) or (d) of the criteria above. We must now determine whether Corporation Z is a financial institution because it is ". . . carrying on the business of a financial institution" as set forth in the remaining criterion (e) above.

T.C.A. § 67-4-804(2)(A) defines the "business of a financial institution". Corporation Z is not a regulated financial corporation nor is it a subsidiary of a regulated financial corporation[1]. Corporation Z does hold and manage investment obligations and loans. But, to manage investment obligations and conduct a loan business, it does not have to be a regulated financial corporation authorized to conduct such a business by federal or state law nor does it have to be a subsidiary of a regulated financial corporation authorized by proper regulatory authorities to conduct such a business. Therefore, Corporation Z is not carrying on the "business of a financial institution" under T.C.A. § 67-4-804(2)(A)(i).

Under T.C.A. § 67-4-804(2)(A)(ii) a corporation is carrying on the "business of a financial institution" if it does, or has authority to do, anything substantially similar to the business that a corporation may be created or authorized to do under Title 45. Title 45 contains the Tennessee statutes under which such companies as banks, savings and loan associations, credit unions, industrial loan and thrift companies, pawnbrokers, issuers of money orders, small business investment companies and industrial development corporations are regulated by the Department of Financial Institutions.

Corporation Z holds and manages investment obligations and loans. Although companies created under Title 45 may hold and manage investment obligations, a company does not have to be created under, or authorized by, Title 45 to conduct such an activity. So, by holding and managing investment obligations, Corporation Z is not carrying on the "business of a financial institution" as defined by T.C.A. § 67-4-804(2)(A)(ii).

T.C.A. § 67-4-804(2)(A)(iii), (iv) and (v) list a number of activities that are defined as carrying on the "business of a financial institution". Corporation Z's business of making loans secured by real property falls within the scope of some of the activities named in the

[1] The language ". . . subsidiary of a holding company or regulated financial corporation . . ." appearing in T.C.A. § 67-4-804(a)(7) means only direct, 1st tier subsidiaries of regulated financial corporations and not 2nd, 3rd, 4th, etc. tier subsidiaries. Indiana, one of the states whose financial institution tax statutes were used as a pattern when Tennessee's financial institution tax statutes were drafted, also applies its similarly worded statute in this way.

subparagraph (iii). But, under the facts presented, less than 50% of Corporation Z's gross income is generated from its loan business. T.C.A. § 67-4-804(2)(B) provides that a corporation shall not be considered to be a financial institution if less than 50% of its gross income is generated by conducting the "business of a financial institution". Since Corporation Z's gross income from its loan business is less than 50% of its total gross income, that activity does not cause it to be carrying on the "business of a financial institution" under T.C.A. § 67-4-804(2)(A)(iii). Corporation Z does not conduct any of the activities described in subparagraphs (iv) and (v).

As is discussed above, none of the applicable Tennessee statutes classify Corporation Z as a financial institution for purposes of the Tennessee franchise, excise tax.

2. CORPORATION Z WILL NOT BE INCLUDED IN A COMBINED FRANCHISE, EXCISE TAX RETURN

T.C.A. §§ 67-4-805(a)(3) and 67-4-914(c) require unitary businesses to file Tennessee corporate franchise, excise tax returns on a combined basis in the manner specified by the law. T.C.A. § 67-4-804(a)(16) defines a unitary business as follows:

> "Unitary business" means business activities or operations of financial institutions that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. "Unitary business" may be applied within a single legal entity or between multiple entities. "Unitary group" includes those entities that are engaged in a unitary business wholly within or within and without this state;
>
> (A) Unity is presumed whenever there is unity of ownership, operation and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting or other controlled interaction among entities that are engaged in the business of a financial institution. The absence of these centralized activities does not, however, necessarily evidence a nonunitary business;
>
> (B) Unity of ownership does not exist unless the corporation is a member of two (2) or more business entities and more than fifty percent (50%) of the voting stock of each member is directly or indirectly owned by:
>
> (i) A common owner or common owners, either corporate or noncorporate; or
>
> (ii) One (1) or more of the members of the group;

Under Tennessee law, a corporation that is a financial institution can not be unitary with a corporation that is not a financial institution because the term "unitary business" is defined by T.C.A. § 67-4-804(a)(16) as the ". . . business activities or operations of financial institutions . . .". Corporation Z is not a financial institution and thus, for purposes of the Tennessee franchise, excise tax, can not be unitary with the Bank Holding Company, the Bank, or any other financial institution in the group.

Since Tennessee law permits only unitary businesses that are financial institutions to be included in a combined franchise, excise tax return and Corporation Z is not a financial

institution, Corporation Z will not be permitted or required to be included in the combined franchise, excise tax return filed by the Bank Holding Company. If Corporation Z does business in Tennessee so as to be subject to Tennessee corporate franchise, excise taxes, it must file its franchise, excise tax return on a separate entity basis to include only its own operations.

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Arnold B. Clapp, Senior Tax Counsel

APPROVED: _____
Ruth E. Johnson, Commissioner

DATE: 7-28-98